Reserve Bank of New Zealand
Te Pūtea Matua

Update on the housing market.

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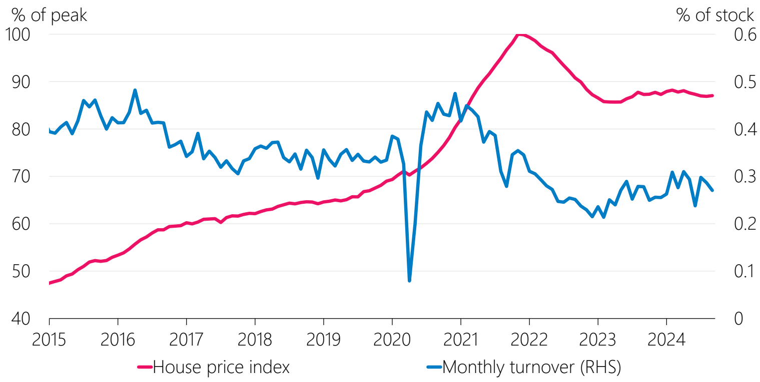
Kelvin Heights. Photo: Charles Lilly

2 Update on the housing market

New Zealand house prices have seen rapid growth and decline in recent years. After a run-up in prices and sales over the first two years of the pandemic, the market experienced broad-based price declines followed by a period of stabilisation. The drivers of this volatility were large changes in monetary policy (interest rates), government policy changes, population growth trends and new housing supply.

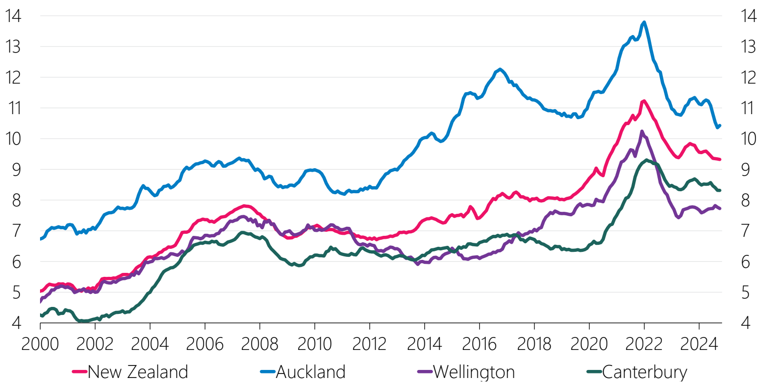
Figure 2.5
House prices and sales
(seasonally adjusted)



Source: REINZ, Stats NZ, RBNZ estimates.

Note: Monthly turnover compares the monthly number of house sales to the total estimated dwelling stock in New Zealand.

Figure 2.6
House price-to-income ratios by region
(median house price as multiple of median household disposable income)



Source: REINZ, Stats NZ, RBNZ estimates.

Houses and land account for most of New Zealand households' wealth, and home loans make up over 60 percent of bank lending. The sustainability of house prices and the risk of correction therefore matter for financial stability.

When house prices are well above sustainable levels, this raises the risk of a sharp correction leading to significant losses on banks' mortgage lending. A stable financial system is critical for long-term economic growth and the well-being of New Zealanders.

This special topic:

- provides an update on current conditions and the near-term outlook for the housing market;
- compares New Zealand's recent house price cycle with house price cycles seen in other countries; and
- discusses how changes to housing supply and macroprudential policies are expected to affect house price cycles in the future.

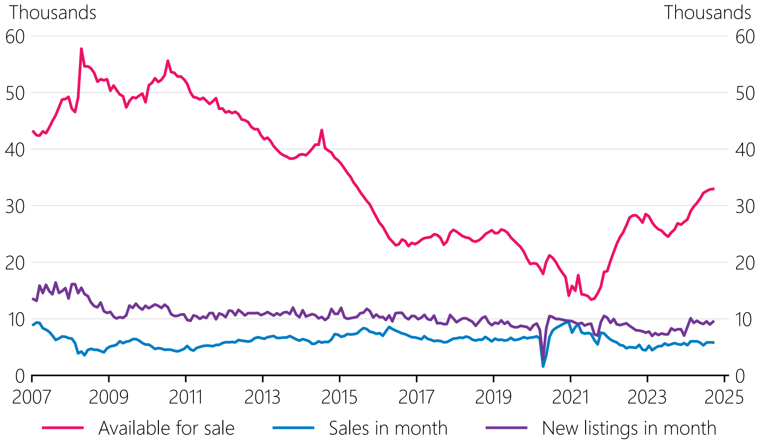
Current developments in the housing market

Housing market activity remains subdued, with prices broadly flat nationally

Activity in the housing market is weak but has picked up modestly over the past year. Sales volumes have recovered as prices have stabilised (figure 2.5). From their peak level in late 2021, prices have fallen an average of 14 percent nationally, although with significant regional variations. Auckland and Wellington prices fell 20 and 23 percent respectively, and have remained relatively flat over the past year. In contrast, prices in Canterbury experienced only modest declines, and have strengthened over the past 18 months. House price-to-income ratios have declined significantly from their peaks (figure 2.6).

New listings on the market have recovered to more typical levels. The stabilisation in prices has given those looking to move houses greater confidence to enter the market. Some owners facing debt-servicing stress may also be looking to downsize. With the volume of sales remaining subdued, inventories have built up in the market over the past year (figure 2.7). The average number of days to sell a property remains elevated.

Figure 2.7
Houses available for sale



Source: realestate.co.nz, REINZ, RBNZ estimates.

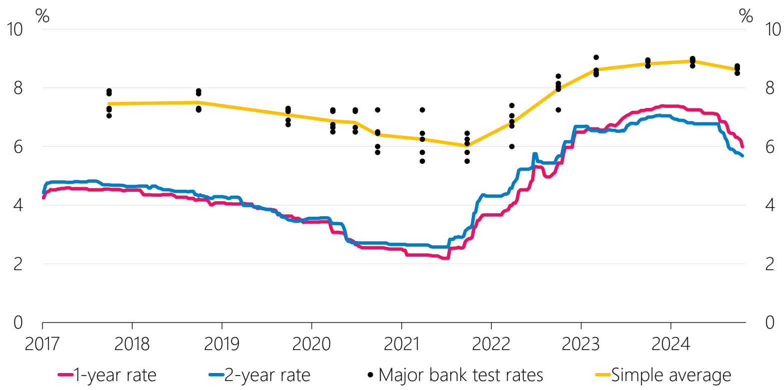
High mortgage rates and lower population growth are limiting housing demand

Advertised mortgage rates have begun to decline over recent months, but they remain at relatively high levels. This is continuing to constrain the borrowing capacity of potential homebuyers. The test interest rates that lenders use to assess borrowers' debt-servicing capacity have fallen, from an average of 9 percent in mid-2024 to around 8 percent in October (figure 2.8).

Banks typically apply a buffer above the average of the 1- or 2-year fixed mortgage rate, although there is some variation in methodologies. Banks generally review their test rates on a quarterly basis. However, given the rapidly changing interest rate environment, some banks reported that they will review their test rates more frequently. Borrowers' capacity to take on more debt could increase quickly given further easing in monetary policy. With low overall lending growth, banks are facing competitive pressures to attract a limited pool of creditworthy borrowers.

The slowdown in New Zealand's population growth due to falling net migration is also dampening housing demand. This is a reversal from the very strong levels of migration seen in 2022-2023, contributing to lower household formation. Growth in rents for new tenancies, which gives an indication of the near-term balance of demand and supply for housing services, has slowed sharply over the past six months (figure 2.9). This will also contribute to slowing consumer price inflation.

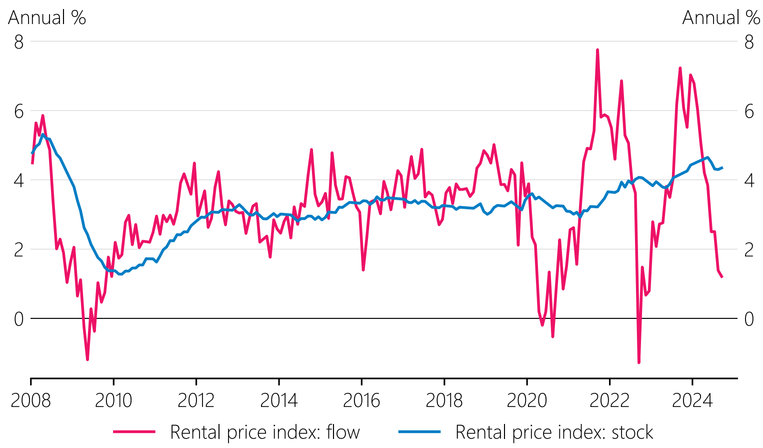
Figure 2.8
Mortgage interest rates and test rates



Source: RBNZ *Credit Conditions survey*, interest.co.nz.

Note: Test rate refers to the interest rate used by banks to assess a prospective borrower's debt capacity and loan affordability. We survey bank test rates in our *Credit Conditions survey* during March and September.

Figure 2.9
Rental inflation



Source: Stats NZ.

House prices remain stretched for prospective buyers, and are around the top of our estimate of sustainable levels

Despite house prices easing, the elevated interest rates mean that purchasing a new house remains relatively unfavourable compared with long-term averages. To assess the sustainability of house prices we consider the mortgage servicing costs for a new buyer, both relative to average household incomes, and relative to the alternative option (renting). These two indicators rose rapidly as house prices were peaking in late 2021, and they have remained at historically high levels (figure 2.10).

Overall, our metrics for house price sustainability suggest that current levels are around the top of the indicator range.[1] This assessment is based on interest rates returning to neutral levels.

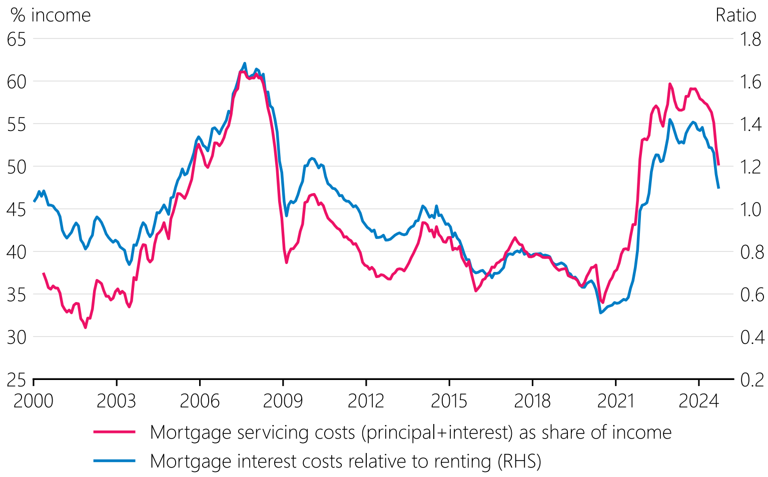
Investor activity remains weak, but may pick up following tax policy changes

Subdued rental inflation means that the expected yields on investment property also remain low compared with borrowing costs. Investors have been relatively inactive in recent years, commanding a low share of total new mortgage lending (figure 2.11).

Recent tax policy changes are favourable for investor demand. The deductibility of mortgage interest costs from taxable rental income will increase to 100 percent in April 2025, from 80 percent currently. Deductibility improves investors' debt-servicing capacity and will increase investors' valuations of existing properties.[2] Since July, the 'bright-line' period for assessing the taxable status of capital gains on investment property has been reduced to two years from 10 years.

Figure 2.10

Selected house price sustainability metrics



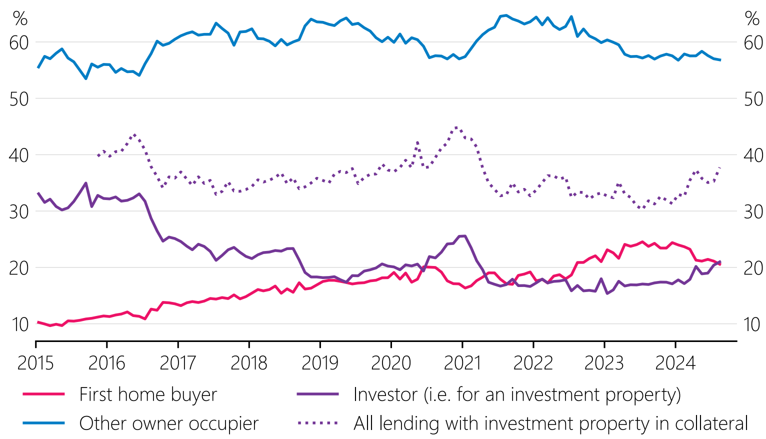
Source: REINZ, Stats NZ, RBNZ estimates.

Note: Mortgage-servicing costs are based on a purchase of the median-priced house with a 2-year fixed-rate loan, at an 80 percent loan-to-value ratio.

Figure 2.11

Share of new mortgage lending commitments by buyer purpose

(share of lending by value, seasonally adjusted)



Source: RBNZ *LVR new commitments survey.*

This change could increase speculative housing purchases, at the margin. In the short term, the change means that investors facing cash flow pressures from high interest rates may seek to sell properties they had been holding on to, due to the previous longer bright-line periods that applied.

1 See https://www.rbnz.govt.nz/financial-stability/financial-stability-indicators.

2 The interest limitation did not apply to purchases of new properties, i.e. interest was fully deductible for lending associated with new property purchase.

In the near term, new build houses will continue to come onto the market

The annual number of new dwelling consents has fallen from its high of 51,000 in 2022 to around 34,000 (figure 2.12). This remains substantially above the level that consents fell to following the Global Financial Crisis (GFC), and is closer to a level that the construction industry can deliver on a long-term basis. The pipeline for new public housing development by Kāinga Ora has also slowed over the past year, contributing to slowing consents.

The large pipeline of consents from recent years continues to convert into completed houses. Industry contacts reported a potential glut of new townhouses in Auckland in recent months, given currently weak demand. A material share of the current property listings in Auckland and Canterbury are new build properties (figure 2.13).

Risks to financial stability from residential development are contained

Prudent lending standards by banks through the boom period mean that any surplus supply of new builds is unlikely to lead to material loan losses for them. Typically banks have required that the value of presales covers at least 100 percent of any borrowings. However, some non-bank lenders that provided additional financing, subordinated to the banks' financing, may take some losses. Developers with unsold stock may also face equity losses if they are unable to achieve their desired prices.

Banks and industry contacts reported that presales of new builds have been weak. Buyers in the current market have the option of purchasing completed new builds, rather than committing to lengthy waits for developers to build off the plans. Banks have generally eased their presale requirements for high-quality developers who have established track records, to around 70 percent of borrowings. Banks want to maintain market share, and feel a competitive pressure to build back up their lending portfolios as projects complete and existing loans are repaid. The Government has announced an underwriting initiative to support new developments given the weakness in presales.[3]

The slowdown in the development pipeline, combined with some financial stresses among developers, has seen many firms exit the industry. Although this is to be expected at the end of a development cycle, a large drop in industry capacity would impair supply responsiveness to future increases in demand.

Figure 2.12

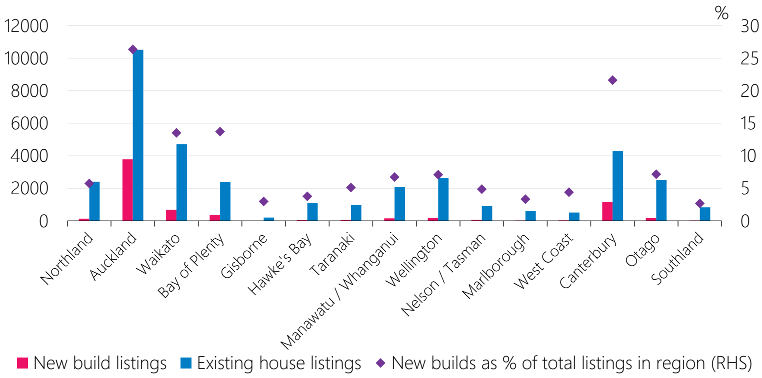
Annual dwelling consents per 1000 working-age people

Source: Stats NZ.

Figure 2.13

New builds among property listings, by region

(October 2024)



Source: Trademe.

3 See https://www.hud.govt.nz/our-work/residential-development-underwrite.

An international perspective on the recent house price cycle

New Zealand's recent house price cycle has been rapid compared to overseas examples, but with comparatively less financial system stress

Over the past five years New Zealand house prices have risen in real terms more rapidly, and declined more rapidly, than in many house price booms and busts in other advanced economies. This includes those associated with financial crises (figure 2.14).

Previous research has highlighted the link between boom-and-bust cycles in house prices and subsequent financial instability.[4] This can arise through several channels, including:

- losses on direct housing loans, particularly for borrowers in negative equity;
- losses on lending for property development and construction, if there is an outsized supply response to high house prices; and
- the amplification effects that large swings in house prices can have on household balance sheets, consumption and broader economic activity, which affect banks' commercial lending.

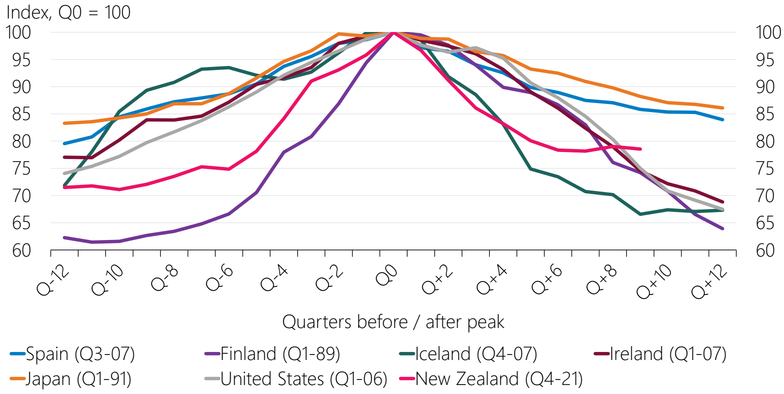
New Zealand's financial system has been resilient to the recent house price cycle

Debt-servicing stresses are currently elevated and non-performing loans continue to climb. However, New Zealand has not yet seen the same widespread household balance sheet distress experienced in countries with similar house price boom-bust cycles. Several factors have mitigated the impacts of the recent house price cycle, including:

- The labour market has been relatively resilient as economic activity has slowed. This has supported household incomes, enabling borrowers to meet higher interest repayments without falling into arrears.

Figure 2.14

Real house price cycles in selected advanced economies



Source: BIS, RBNZ calculations.

Note: Nominal house prices are adjusted by the consumer price index or equivalent.

- The high inflation environment, including wage inflation, has eroded the real value of borrowers' debts. This contrasts for example with Ireland in the GFC, where multiple years of deflation raised real debt burdens.
- Banks' lending standards have meant borrowers have had financial buffers in place to handle shocks. Stringent testing of new borrowers' servicing capacity has meant they have been able to absorb large increases in interest rates. Loan-to-value ratio (LVR) requirements, including speed limits applied by the Reserve Bank, have meant that borrowers can absorb substantial price declines without falling into negative equity. We estimate that less than 2 percent of the current stock of lending is to borrowers in negative equity. In addition, as discussed above, banks' stringent presale requirements have limited the extent of risky property development.
- House prices were at or near their peak level for only a brief period. This meant that a limited proportion of buyers from recent years purchased their properties at prices close to the peak. A prolonged period of purchases at unsustainable prices would have led to a larger accumulation of risk.

4 See for example Thornley (2016), Financial stability risks from housing market cycles, RBNZ Bulletin. https://www.rbnz.govt.nz/hub/publications/bulletin/2016/rbb2016-79-12.

Longer-term policy developments

Policy changes aim to improve long-term supply responsiveness

The Government has announced a package of policy measures that aim to improve housing supply responsiveness. Under the "Going for Housing Growth" programme, central government is working with local authorities to reform urban planning settings and infrastructure financing models, so that housing supply can be more responsive to demand.[5]

The Housing Technical Working Group – a joint initiative of the Treasury, the Ministry of Housing and Urban Development, and the Reserve Bank – was established to better understand the key drivers of the housing market. Its research has found that restrictions on land supply responsiveness have meant that declines in long-term interest rates over recent decades have resulted in higher house prices.[6] With greater supply responsiveness, this trend in interest rates would instead have stimulated the construction of new houses and put downward pressure on rents.

The first phase of the Government's programme will require councils to:

- amend their planning rules to allow for 30 years' worth of feasible housing capacity;
- increase allowed intensification along strategic transport corridors; and
- remove urban-rural boundary lines to enable greenfield growth.

The Medium Density Residential Standards (MDRS), another planning instrument mandated by central government in 2022, aims to allow for greater densification of existing urban areas by removing resource consenting requirements. The MDRS will become optional for councils under the Government's changes. Several councils have already adopted MDRS in their planning rules. Councils that have yet to adopt it, or that want to remove it from their rules, will be able to opt out only if they can demonstrate they will meet the 30-year capacity target in alternative ways (e.g. through greenfield development).

Phase two of the programme will look at constraints on infrastructure provision, including financing models. Having infrastructure in place means that the supply capacity enabled by planning changes can be realised in practice.

The details of these policy changes will take some time to develop, and it may be several years before they take full effect in councils' planning rules. While the programme is unlikely to impact housing supply in the near term, if successful it will help to moderate the extent to which future shifts in demand, such as from interest rates, contribute to house price cycles.

Debt-to-income restrictions will help to moderate demand cycles and the build-up of risk

In July 2024 we activated limits on banks' high debt-to-income (DTI) mortgage lending.[7] Under the rules, banks can lend no more than:

- 20 percent of new owner-occupier lending to borrowers with DTI ratios greater than 6, and
- 20 percent of new investor lending to borrowers with DTI ratios greater than 7.

Banks already undertake affordability assessments of borrowers using calculations that account for individual circumstances. This includes borrowers' expenses and their different forms of income, which are not easily captured in a simple metric such as the DTI ratio. DTI ratios perform better at capturing risks to loan servicing at an aggregate level.

In addition, DTI limits will act as guardrails on banks' lending without needing the Reserve Bank to regularly adjust the limits. If interest rates decline, borrowers' DTIs are likely to trend up, and the policy setting will effectively become tighter. This provides an offset against the potential build-up of financial stability risks.

5 See https://www.hud.govt.nz/our-work/going-for-housing-growth-programme.

6 See https://www.treasury.govt.nz/publications/jp/assessment-housing-system-insights-hamilton-waikato-area and https://www.treasury.govt.nz/publications/jp/what-drives-rents-new-zealand-national-and-regional-analysis.

7 See https://www.rbnz.govt.nz/hub/news/2024/05/reserve-bank-activates-debt-to-income-restrictions.